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8 UNITED STATES DISTRICT COURT  
9 SOUTHERN DISTRICT OF CALIFORNIA  
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11	WATERMARK GRANITE LA QUINTA, )	Civil No. 10cv1011-L(CAB)
12	LLC <i>et al.</i> , )	
13	Plaintiffs, )	<b>ORDER GRANTING</b>
14	v. )	<b>DEFENDANT'S MOTION TO</b>
15	AMERICAN INTERNATIONAL )	<b>DISMISS</b>
16	SPECIALTY LINES INSURANCE )	
17	COMPANY, )	
	Defendant. )	

18 In this insurance action, real estate developers and insureds Watermark Granite La  
19 Quinta, LLC and Innovative Communities, Inc. ("Plaintiffs") filed an action against their insurer,  
20 Defendant American International Specialty Lines Insurance Company, to recover insurance  
21 premiums paid in relation to two failed projects. The court has subject matter jurisdiction  
22 pursuant to 28 U.S.C. Section 1332(a)(1). Defendant filed a motion to dismiss the second  
23 amended complaint. Plaintiffs opposed and Defendant replied. For the reasons which follow,  
24 Defendant's motion is **GRANTED**.

25 According to Plaintiffs, prior to commencing construction on the projects, they obtained  
26 policies to insure the construction and sale of homes, primarily against claims of defective  
27 construction by third party purchasers. (Opp'n at 1; Second Am. Compl. ("Compl.") at 3.) They  
28 took out Policy No. BE-9745437, effective from December 10, 2004 to October 7, 2007, for the

1 Mesa Verde project for construction of 200 residences and related infrastructure. (Compl. at 4.)  
2 They took out Policy No. BE-7412308, effective from May 1, 2005 to April 14, 2008, for the  
3 Watermark project for construction of 250 condominiums and related infrastructure. (*Id.* at 5.)  
4 In exchange for coverage in the aggregate amount of \$10 million on each project, Defendant  
5 demanded and received from Plaintiffs Advance Premiums totaling approximately \$1.3 million.  
6 (*Id.* at 4 & 5.)

7 Due to the deteriorating real estate and credit markets, Plaintiffs' projects were not  
8 completed. (Opp'n at 1.) With respect to the Mesa Verde project, Plaintiffs completed the  
9 infrastructure work and built and sold 64 residences. (Compl. at 4.) The remaining 136 finished  
10 lots were sold to Centex Homes. (*Id.*) As to the Watermark project, they almost completed the  
11 infrastructure and eight model units before losing financing and the lender taking possession of  
12 the property. (*Id.* at 5.)

13 Subsequently, Plaintiffs informed Defendant that the projects did not reach the scope of  
14 construction anticipated when the insurance policies were issued. Plaintiffs maintain that the  
15 actual amount due as Advance Premium was based on Defendant's own internal formula and  
16 calculation of the risk it was assuming for the construction and sale of a specific number of  
17 homes. (Opp'n at 1; *see also* Compl. at 4 & 5.) They demanded that Defendant audit the  
18 premiums in light of the failed projects and return a portion of the premiums paid, representing  
19 the difference between the premiums paid and earned. (Compl. at 5 & 6.) After Defendant  
20 refused to audit the premiums or return any of them, Plaintiffs filed the instant action. (*Id.* at 6-  
21 7.)

22 Plaintiffs asserted three causes of action styled as unjust enrichment, conversion, and  
23 rescission. The unjust enrichment and rescission claims are based on the theory that the  
24 insurance policies were executed pursuant to the mutual material mistake of fact "that the homes,  
25 lots and infrastructure would be completed as planned and would require the coverage to be  
26 provided under each of the respective Policies." (Opp'n at 6; *see also id.* at 10; Compl. at 7.)  
27 Plaintiffs also base the claims on failure of consideration, "the parties based the entire  
28 consideration for the agreement on their mistaken belief that the number of homes provided for

1 in the policy were actually going to be constructed and the gross sales were going to reach  
2 certain amounts. Without that happening of a future event, the policies were stripped of any true  
3 consideration.” (Opp’n at 10; *see also* Compl. at 4.) Plaintiffs claim that they are “entitled to  
4 recover premiums that [they] paid for insurance that was never rendered because the risk of  
5 exposure never existed.” (Opp’n at 2.) The conversion claim is based on the theory that  
6 Defendant wrongfully declined to return any portion of the premiums when asked by Plaintiffs.  
7 (Compl. at 8.)

8 Defendant moved pursuant to Federal Rule of Civil Procedure 12(b)(6) to dismiss all  
9 three claims and strike pursuant to Rule 12(f) the request for punitive damages. A Rule 12(b)(6)  
10 motion tests the sufficiency of the complaint. *Navarro v. Block*, 250 F.3d 729, 732 (9th Cir.  
11 2001). Dismissal is warranted under Rule 12(b)(6) where the complaint lacks a cognizable legal  
12 theory. *Shroyer v. New Cingular Wireless Serv., Inc.*, 622 F.3d 1035, 1041 (9<sup>th</sup> Cir. 2010)  
13 (internal quotation marks and citation omitted); *see Neitzke v. Williams*, 490 U.S. 319, 326  
14 (1989) (“Rule 12(b)(6) authorizes a court to dismiss a claim on the basis of a dispositive issue of  
15 law”). Alternatively, a complaint may be dismissed where it presents a cognizable legal theory  
16 yet fails to plead essential facts under that theory. *Robertson v. Dean Witter Reynolds, Inc.*, 749  
17 F.2d 530, 534 (9th Cir. 1984); *see also Shroyer*, 622 F.3d at 1041. “In addition, to survive a  
18 motion to dismiss, a complaint must contain sufficient factual matter to state a facially plausible  
19 claim to relief.” *Shroyer*, 622 F.3d at 1041, citing *Ashcroft v. Iqbal*, \_\_ U.S. \_\_, 129 S. Ct. 1937,  
20 1949 (2009). In reviewing a motion to dismiss under Rule 12(b)(6), the court must assume the  
21 truth of all factual allegations and must construe them in the light most favorable to the  
22 nonmoving party. *Cahill v. Liberty Mut. Ins. Co.*, 80 F.3d 336, 337-38 (9th Cir. 1996). Legal  
23 conclusions need not be taken as true merely because they are couched as factual allegations.  
24 *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555 (2007). Similarly, “conclusory allegations of law  
25 and unwarranted inferences are not sufficient to defeat a motion to dismiss.” *Pareto v. Fed.*  
26 *Deposit Ins. Corp.*, 139 F.3d 696, 699 (9th Cir. 1998).

27 Defendant argues that the unjust enrichment and rescission claims should be dismissed  
28 because Plaintiffs cannot show a mutual mistake as a matter of law. California substantive law

1 applies in this diversity action. *Intr-Plex Technol., Inc. v. Crest Group, Inc.*, 499 F.3d 1048,  
 2 1052 (9<sup>th</sup> Cir. 2007). California Civil Code Section 1577 defines a mistake of fact:

3 Mistake of fact is a mistake, not caused by the neglect of a legal duty on the part of  
 4 the person making the mistake, and consisting in:

- 5 1. An unconscious ignorance or forgetfulness of a fact past or present, material to  
 the contract; or,
- 6 2. Belief in the present existence of a thing material to the contract, which does not  
 exist, or in the past existence of such a thing, which has not existed.

7 Because Plaintiffs' mistake theory is based on the anticipation about how the projects would turn  
 8 out in the future, there was no mistake about a past or present fact, and therefore no mistake of  
 9 fact.

10 Plaintiffs rely on *F.P. Cutting Co. v. Peterson*, 164 Cal. 44 (1912) for the proposition that  
 11 mistake regarding a future event is sufficient to support unjust enrichment or rescission. *F.P.*  
 12 *Cutting* holds that when a contingency, which both parties anticipated to happen after contract  
 13 formation and which was expressly incorporated in the contract, does not occur, the court may  
 14 reform the contract so as to conform it to the parties' mutual intent at the time of contract  
 15 formation. The parties in *F.P. Cutting* entered into a futures contract whereby the plaintiff, a  
 16 fruit and vegetable canner, sold a quantity of canned tomatoes to the defendant, a wholesale  
 17 grocer. They agreed that if the price specified in the contract was higher than the price to be set  
 18 by the California Fruit Canners Association's price list at the beginning of the season, then the  
 19 association's price would govern the contract. The intent was to protect the defendant from  
 20 paying more for the tomatoes than the association's opening price. However, contrary to the  
 21 established practice, the association did not publish a price list at the beginning of the season,  
 22 although its opening prices were ascertainable from the market. The court interpreted the  
 23 contract provision referencing the price list as referring to the market prices to be fixed by the  
 24 association at the beginning of the season, regardless of the fact that they were not published in a  
 25 price list.

26 *F.P. Cutting* is inapposite because, unlike here, the association prices were an assumption  
 27 expressly included in the agreement. "Absent evidence that the existence of a future  
 28 contingency . . . is an assumption of the contract . . . the defense of mistake of fact must be

1 premised on past or present facts about which the parties are ignorant or mistaken.” *Mosher v.*  
2 *Mayacamas Corp.*, 215 Cal. App. 3d 1, 5 (1989). Plaintiffs do not argue that the alleged mistake  
3 is premised on a past or present fact but on Plaintiffs’ future success in completing the projects.  
4 To state a claim on this basis, the future contingency must be an assumption of the contract, as  
5 was the case in *F.P. Channing*.

6 The insurance policies show that the scope of completion of Plaintiffs’ projects was not  
7 an assumption. (Decl. of Sanford Kingsley Exh. A & Am. Exh. B.) Generally, a court may not  
8 consider material beyond the complaint in ruling on a Rule 12(b)(6) motion. *Intri-Plex Tech.*,  
9 499 F.3d at 1052; *see also* Fed. R. Civ. Proc. 12(d). However, the court may take judicial notice  
10 of and consider “materials incorporated into the complaint or matters of public record.” *Coto*  
11 *Settlement v. Eisenberg*, 593 F.3d 1031, 1038 (9th Cir. 2010) (citations omitted). The doctrine  
12 of incorporation by reference includes “documents in situations where the complaint necessarily  
13 relies upon a document or the contents of the document are alleged in a complaint, the  
14 document’s authenticity is not in question and there are no disputed issues as to the document’s  
15 relevance.” *Id.* (citations omitted). Because the policies and their contents are alleged in the  
16 operative complaint (Compl. at 3-5), Plaintiffs do not contest their authenticity, and they did not  
17 object, the court takes judicial notice of them.

18 Plaintiffs alleged that the Advance Premiums were calculated based on the planned scope  
19 of each project. (*See, e.g.*, Compl. at 4 (“The amount of Advance Premium . . . was based on the  
20 anticipated construction and sale of a total of 200 single family homes.”) & 5 (same re: policy  
21 for the Watermark project).) These allegations are contradicted by the unambiguous language of  
22 the policies, which state that the Advance Premium was not computed based on any rate or  
23 formula, but was a flat rate. (Decl. of Sanford Kingsley Exh. A & Am. Exh. B at AISLIC 0001  
24 & 0075 (Declarations, Item 6)). Plaintiffs did not pay any other premiums for the policies. (*Id.*)  
25 The court need not assume the truthfulness of allegations which are contradicted by judicially  
26 noticeable documents. *Branch v. Trunnell*, 14 F.3d 449, 454 (9<sup>th</sup> Cir. 1994), *overruled on other*  
27 *grounds by Galbraith v. County of Santa Clara*, 307 F.3d 1119, 1127 (9<sup>th</sup> Cir. 2002); *Intri-Plex*  
28 *Tech.*, 499 F.3d at 1053. The policy provisions that none of Plaintiffs’ premiums were computed

1 but were flat, negate Plaintiffs' premise that the scope of project completion was a future  
2 contingency the parties assumed in the calculation of the premiums.

3 Plaintiffs' premise is further precluded by the provision which renders the premiums non-  
4 refundable. Each policy provides:

5 When this policy expires or if it is cancelled, we will compute the earned premium  
6 for the time this policy was in force. **If** this policy is subject to audit adjustment,  
7 the actual exposure base will be used to compute the earned premium. If the  
8 earned premium is greater than the Advance Premium, you will promptly pay us  
9 the difference. If the earned premium is less than the Advance Premium, we will  
10 return the difference to you. **But in any event, we will retain the Minimum  
11 Premium as shown in Item 6 of the Declarations for each twelve months of the  
12 Policy Period.**

13 (Decl. of Sanford Kingsley Exh. A & Am. Exh. B at AISLIC 0065 & 0140 (emphases added).)  
14 In Plaintiffs' policies, the Advance Premium and the Minimum Premium are co-extensive. (*Id.*  
15 at AISLIC 0001 & 0075 (Declarations, Item 6).) Accordingly, Defendant was entitled to retain  
16 all of the premiums paid by Plaintiffs, regardless of the actual completion of the projects and the  
17 resulting exposure to risk. Because the policies preclude Plaintiffs' argument that the future  
18 contingency of the completion of the entire scope of the projects was an assumption included in  
19 the contract, their contention that they can state a claim for unjust enrichment or rescission based  
20 on mutual mistake regarding a future fact is rejected.

21 Alternatively, Plaintiffs argue that their inability to complete the projects, combined with  
22 the premium provisions which were not dependent on the extent of completion, caused a failure  
23 of consideration so as to warrant rescission or restitution. According to Plaintiffs, "insurance  
24 was not provided for the vast majority of homes contemplated because the homes were never  
25 built. Plaintiffs seek reimbursement of the advance premiums on the grounds the insurance  
26 promised was never provided because the homes were never constructed." (Opp'n at 9.)

27 Specifically, Plaintiffs argue they alleged "that the policy endorsements [endorsement No.  
28 6] are unenforceable because any enforcement would strip each and every policy of any  
consideration." (Opp'n at 4.) Upon review of the second amended complaint, this does not  
appear to be alleged and Plaintiffs provided no citation to the complaint in their opposition brief.  
Moreover, the reference to endorsement no. 6 does not make sense in the context of this case. In

one policy, it is a “Chromated Copper Arsenate (“CCA”) Exclusion Endorsement (Decl. of Sanford Kingsley Exh. A at AISLIC 0014), and in the other it is a “Continuing or Progressively Deteriorating Damages Endorsement” (*id.* Am. Exh. B at AISLIC 0085). The court therefore construes Plaintiffs’ argument as referring to the provision in each policy for a non-refundable Minimum Premium, located at Section VI, Paragraph M in each policy. (*Id.* Exh. A & Am. Exh. B at AISLIC 0065 & 0140.)

Plaintiffs further argue that because this provision causes a failure of consideration, it should be set aside as unenforceable, and that “the original policy language as provided in Section IV(5)(b) controls and Defendant is obligated to conduct a premium audit and return any unearned premiums.” (Opp’n at 4.) Upon a thorough review of both policies, the court is unable to locate a Section IV(5)(b). Plaintiffs provided no citation where the section could be found in the policy documents. Section IV of each policy pertains to Limits of Insurance and has no bearing on Plaintiffs’ argument. (*See* Decl. of Sanford Kingsley Exh. A & Am. Exh. B, documents listed at AISLIC 0053-55 & 0128-130; *see also* 0009, 0017, 0023, 0028, 0089, 0097, 0101, 0111, 0120.) Moreover, the paragraphs of all sections in the policies are designated by capital letters and not numbers. The court therefore construes the argument to refer to Section VI., Paragraph M, the only policy provision pertaining to premiums. (*Id.* at AISLIC 0065 & 0140.) Section IV, Paragraph M is not the subject of any endorsements to the policies, but consists entirely of “original language.” The court therefore further construes Plaintiffs’ argument as attempting to excise the last sentence of Paragraph M, which provides, “But in any event, we will retain the Minimum Premium as shown in Item 6 of the Declarations for each twelve months of the Policy Period.” (*Id.* at AISLIC 0065 & 0140.)

Plaintiffs’ argument is based on the premise that “without any homes the policies are not worth anything more than the paper they are written on. Plaintiffs expressly and repeatedly allege that [Defendant] has failed to provide the coverage contemplated by the policies because there is nothing to insure.” (Opp’n at 4.) This argument is negated by Plaintiffs’ own allegations that they started the construction of both projects and in some cases sold completed homes and lots. Plaintiffs do not contend that they did not have the benefit of insurance



1 coverage for the portion of each project they completed. One therefore cannot reasonably infer  
 2 based on the allegations in the complaint that Plaintiffs received nothing at all from Defendant in  
 3 exchange for the premiums. The fact that the insurance coverage turned out to be less valuable  
 4 to Plaintiffs than anticipated does not render the policies or their premium provisions  
 5 unenforceable for lack of consideration.

6 Any benefit conferred, or agreed to be conferred, upon the promisor, by any other  
 7 person, to which the promisor is not lawfully entitled, or any prejudice suffered, or  
 8 agreed to be suffered, by such person, other than such as he is at the time of  
 consent lawfully bound to suffer, as an inducement to the promisor, is a good  
 consideration for a promise.

9 Cal. Civ. Code § 1605 ; *see also Jara v. Suprema Meats, Inc.*, 121 Cal. App. 4th 1238, 1249  
 10 (2004) citing Cal. Civil Code § 1605. Accordingly, “the consideration need not necessarily be  
 11 useful, and there is no requirement of adequacy to make the contract enforceable in an action at  
 12 law.” 1 B.E. Witkin, Summary of Cal. Law, Contracts § 140 (10<sup>th</sup> ed. 2005) citing Restatement  
 13 (Second) of Contracts § 79(b) & cmt. c. Plaintiffs’ contention that they are entitled to a refund  
 14 of premiums based on failure of consideration is therefore negated by the allegations in the  
 15 second amended complaint. Defendant’s motion to dismiss the unjust enrichment and rescission  
 16 claims is therefore **GRANTED**.

17 Last, Defendant argues that the conversion claim should be dismissed because Plaintiffs  
 18 failed to allege a wrongful act to support it. Plaintiffs’ theory of conversion is that Defendant’s  
 19 refusal to conduct an audit and refund the premiums constituted the requisite wrongful act. To  
 20 establish a wrongful act, Plaintiffs must have had ownership, possession, or right to possession  
 21 of the property in dispute. *See* Judicial Council of Cal. Civ. Jury Instr. No. 2100 (Spring 2011  
 22 Ed.). Plaintiffs’ conversion claim is based on their argument that Defendants were not entitled  
 23 to the premiums because of the mutual mistake of fact and failure of consideration. Because  
 24 both arguments are rejected for reasons discussed above, Defendant’s motion to dismiss the  
 25 conversion claim is **GRANTED**.

26 Plaintiffs did not request leave to amend the complaint if the motion to dismiss is granted.  
 27 Nevertheless, the court must consider whether a motion to dismiss should be granted with leave  
 28 to amend. *Schreiber Distrib. Co. v. Serv-Well Furniture Co., Inc.*, 806 F.2d 1393, 1401 (9th Cir.



2004). Rule 15 advises the court that leave to amend shall be freely given when justice so requires. Fed. R. Civ. P. 15(a). "This policy is to be applied with extreme liberality." *Eminence Capital, LLC v. Aspeon, Inc.*, 316 F.3d 1048, 1051 (9th Cir. 2003) (internal quotation marks and citation omitted).


In the absence of any apparent or declared reason -- such as undue delay, bad faith or dilatory motive on the part of the movant, repeated failure to cure deficiencies by amendments previously allowed, undue prejudice to the opposing party by virtue of allowance of the amendment, futility of amendment, etc. -- the leave sought should, as the rules require, be "freely given."

*Foman v. Davis*, 371 U.S. 178, 182 (1962). Dismissal with prejudice and without leave to amend is not appropriate unless it is clear that the complaint could not be saved by amendment. *Id.* Based on the allegations in the second amended complaint and provisions of the insurance policies, it does not appear that Plaintiffs could amend the complaint.

Accordingly, Defendant's motion to dismiss is **GRANTED**. Its motion to strike the demand for punitive damages is **DENIED** as moot. The second amended complaint is **DISMISSED** without leave to amend.

**IT IS SO ORDERED.**

DATED: May 23, 2011

  
M. James Lorenz  
United States District Court Judge

COPY TO:

HON. CATHY ANN BENCIVENGO  
UNITED STATES MAGISTRATE JUDGE

ALL PARTIES/COUNSEL